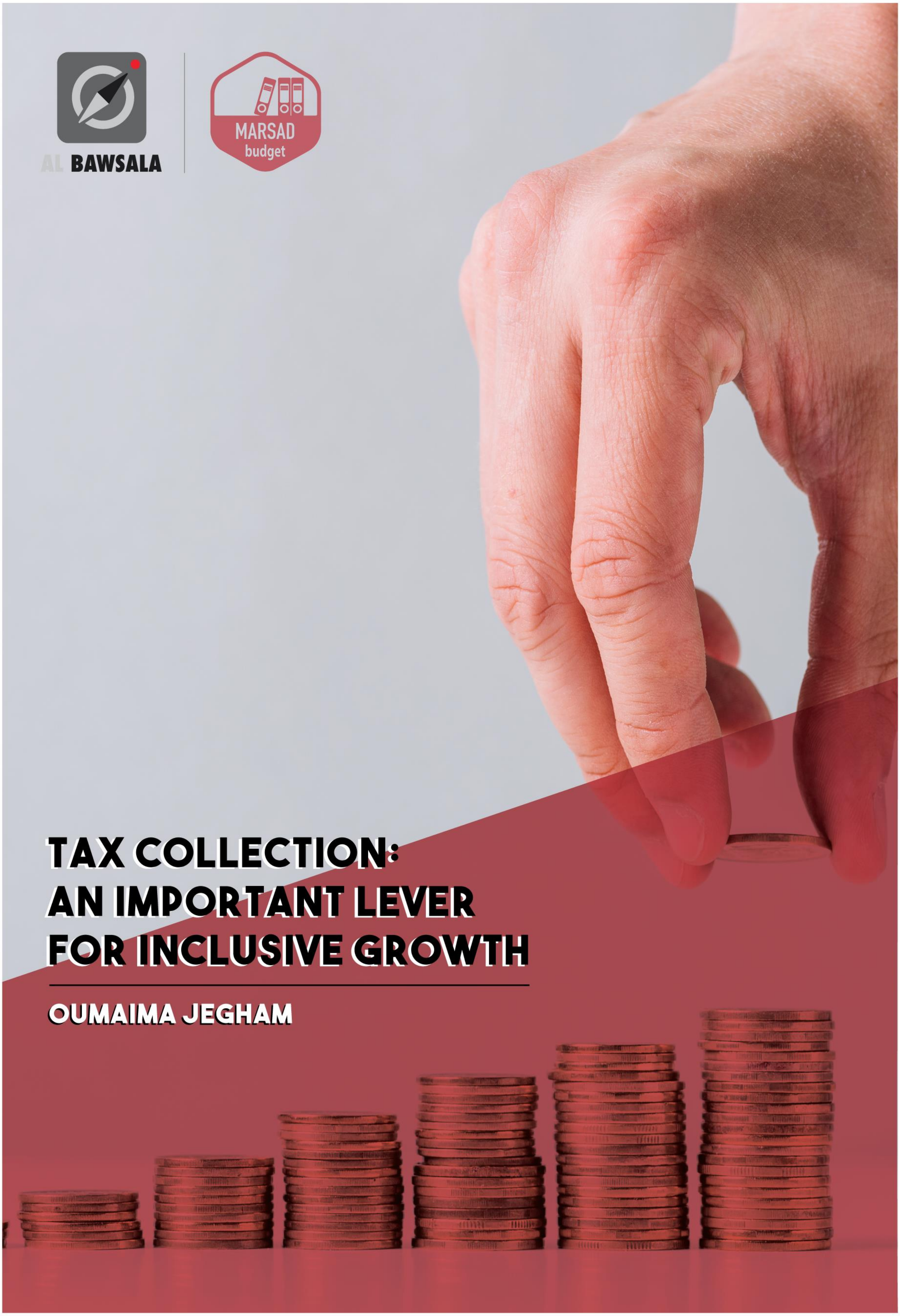

TAX COLLECTION: AN IMPORTANT LEVER FOR INCLUSIVE GROWTH

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Summary

Fiscal policies are one of the main tools available to public authorities to intervene in and enhance economic growth and social development. In 2014, Tunisia started implementing its fiscal reform by tackling various types of tax, including income tax, corporate tax and value added tax. This reform was driven by the rapid increase in public spending, which in turn required better tax collection and higher tax revenue. These tax reforms ended up burdening consumers, most notably low income groups, and failed to fully include small producers, who are major actors in the Tunisian economy. Thus, establishing a less burdensome, more progressive, and more inclusive fiscal system is crucial for increasing economic activities and ensuring social stability.

Tax Collection: An Important Lever for Inclusive Growth

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The post-revolutionary period in Tunisia has revealed the full extent of the country's dire economic and social situation, and has been accompanied by political, economic, and financial reforms.

In May 2013, the Ministry of Finance launched a deep and structural reform of the tax system, which was halted by November 2014. Reforms included a review of the taxes and rates already in force, and grouping scattered fiscal provisions into one single code. However, when reaching the implementation phase, the grouping section of the reform was dropped, and only the urgently needed fiscal provisions were implemented by consecutive finance laws.

In addition, the overall economic situation is far from reassuring; even the most positive indicators are considered insufficient to resolve the crisis. For example, the growth rate, expected to reach 2.7 percent,[i] is not high enough to reduce the unemployment rate, currently fixed at 15.4 percent.[ii] At the same time, the budget deficit continues to worsen, reaching 6.1 percent of GDP in 2017.[iii] Following the same trend, public debt is expected to reach 71.4 percent of GDP, according to calculations provided by the Finance Law of 2018.[iv] Moreover, the 2018 Gini index of distribution stands at 30.9 percent.[v] According to the Tunisian Forum for Economic and Social Rights, 1,490 social movements were registered in January 2018, most of which were formed in response the new fiscal provisions presented in the Finance Law of 2018.[vi]

Taking the current state of affairs into consideration, it is imperative for the Tunisian government to institute policies to ensure social justice and revive economic activities. Promoting inclusive growth through the application of pro-poor policies together with pro-growth economic policies could provide the solution to the economic and social crisis the country is currently facing.

In the interest of inclusive growth, the Tunisian state must incorporate equity and fiscal justice into its fiscal policy, as required by Article 10 of the new Constitution: "Paying taxes and contributing towards public expenditure are obligations, through a fair and equitable system."[vii]

The Impact of Direct Taxation on Low-Income Households and SMEs

Taxes are divided into two groups: direct and indirect. Direct taxes are paid directly by an individual or organization, and usually consist of income taxes, corporate taxes and taxes on capital (such as properties or land). Indirect taxes, commonly known as value added tax and consumption duties, are passed onto consumers as part of the purchase price of goods or services. They are usually collected by one entity in the supply chain and are finally paid to the government.

Income Tax

Tax may also be understood in terms of its progressivity or non-progressivity. Progressivity entails increasing the tax rate according to the increase in the taxable amount, while proportional taxes have a fixed tax rate regardless of the taxable amount. Unlike proportional tax, progressive tax plays a major role in reducing inequalities through imposing rates that are dependent on income levels. This implies that the lowest income groups pay a smaller amount compared to high-income groups, without impacting the living standards of either.

Income tax is commonly associated with progressivity. In Tunisia, income tax has witnessed few changes over the years. Since the country gained independence in 1956, income tax has only been reviewed three times: the first adjustment was in 1986, followed by another revision in 1989 as part of the structural adjustment plan, and the latest change took place in 2017.

As Table 1 illustrates, tax brackets have been dramatically revised between 1986 and 2017, in accordance with attempts to make the tax system less complicated. However, income tax has retained its progressive character, which guarantees the principle of tax justice, where tax payers contribute according to their income, and the most vulnerable social economic groups are exempt from paying.

Table 1: Individual Income Tax Rates (1986-2017)

1986-1989	
Tax Bracket	Tax rate
0 à 900 dinars	0%
900 à 1300 dinars	5%
1300 à 1500 dinars	10%
1500 à 2000 dinars	15%
2000 à 2500 dinars	20%
2500 à 3000 dinars	25%
3000 à 3500 dinars	30%
3500 à 4000 dinars	36%
4000 à 5000 dinars	42%
5000 à 6000 dinars	48%
6000 à 8000 dinars	54%
8000 à 10000 dinars	56%
10000 à 14000 dinars	58%
14000 à 25000 dinars	60%
25000 à 40000 dinars	62%
40000 à 60000 dinars	64%
60000 à 80000 dinars	66%
Au-delà de 80000 dinars	68%

1989-2016	
Tax Bracket	Tax rate
0 à 1 500 Dinars	0%
de 1 500,001 à 5 000 Dinars	15%
de 5 000,001 à 10 000 Dinars	20%
de 10 000,001 à 20 000 Dinars	25%
de 20 000,001 à 50 000 Dinars	30%
Plus de 50.000 dinars	35%

2017-Now	
Tax Brackets	Tax rate
0 à 5000	0%
5.000,001 à 20.000	26%
20.000,001 à 30.000 dinars	28%
30.000,001 à 50.000 dinars	32%
Plus de 50.000 dinars	35%

Source: figures from the Ministry of Finance.[viii]

One 2017 study[ix] on fiscal policy, income redistribution and poverty reduction in Tunisia has found that two-thirds of inequality reduction arises from applying income tax and social programs such as subsidies.[x]

The same study analyzed the income tax burdens on various social economic groups, and the findings indicate that the poorest groups tend to pay relatively high rates of income tax and social security contributions compared to their net market income. Income tax figures from 1989 until 2016 show that low-income groups earning under the minimum wage were taxed at very high rates, even when inflation started to grow in 2013. The new income tax system, introduced in 2017, has reduced the tax burden on the lowest income groups: prior to 2017, an individual earning 6,300 TND a year paid tax on 11.43 percent of their monthly income, compared to only 5.36 percent now.

Even though these changes have brought about a remarkably lower tax burden on low-income groups, it is still not enough, especially when considering the dramatic increase in the inflation rate, from 4.8 percent in 2017 to 7.5 percent in 2018.

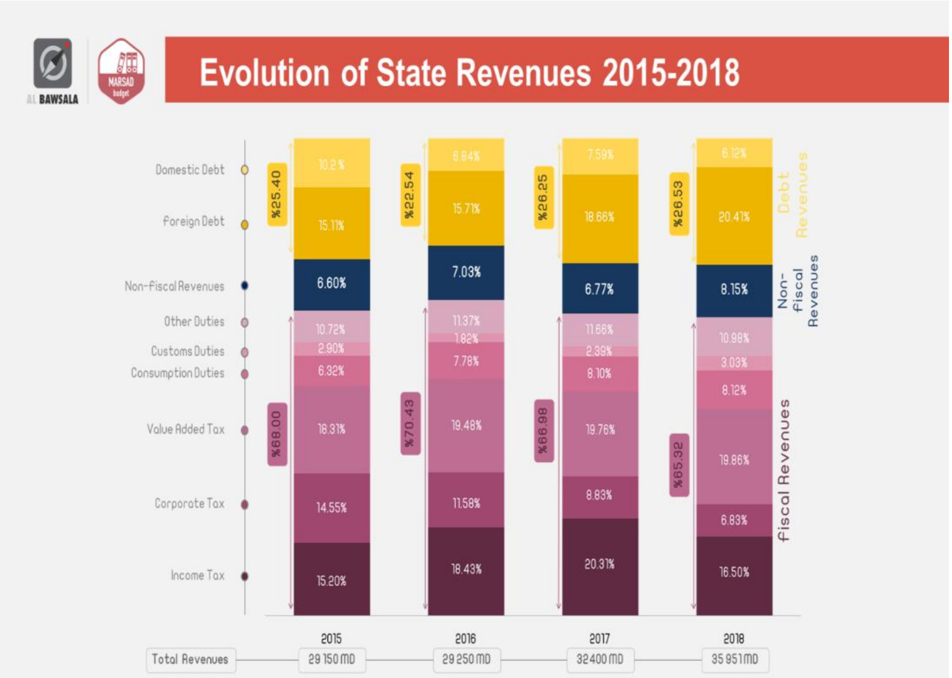
Corporate Tax

The other pillar of Tunisian tax revenues is corporate tax (CT). Unlike income tax, CT is not progressive and the same tax rate is usually applied to all taxpayers, regardless of their profits. This type of tax is called a proportional tax.

Most CT payers are local and foreign companies established in Tunisia, as well as non-resident, non-established legal entities with a Tunisian income. These companies must pay a proportion of their revenues on a quarterly basis. The CT rate was initially set at 35 percent by Law No. 80 of 2006, however, from 2007 onwards, this rate gradually declined, reaching 25 percent in 2014.[xi]

Corporate tax rates vary according to industrial sector. For instance, agricultural and crafts companies, exporters, and firms who mostly hire young people all pay a reduced rate of 10 percent, while companies operating in the financial, communication, insurance, and oil sectors pay 35 percent of their revenues.

One aspect of reducing inequalities and promoting inclusive growth is through economic prosperity, thus providing an easily accessible market to all. Over recent years, the reduction in corporate tax and other fiscal provisions has been interpreted as tax incentives for companies to increase production and hire more people. However, as indicated in the graph below, the share of corporate tax in overall state revenue has halved since 2015.



Source: Al Bawsala, January 15, 2018.[xii]

The Finance Law of 2018 introduced a new provision that imposes a 20 percent tax rate on small and medium enterprises whose revenue does not exceed one million TND for commercial activities, and 500,000 dinars for non-commercial activities. This tax is applied progressively, so that companies pay according to their revenues.

The Impact of Indirect Taxes on Low-Income Groups

Value Added Tax

Value added tax (VAT) was a product of the structural adjustment plan introduced in the 1980s. Prior to that, the Tunisian government imposed consumption duties, which mostly applied to alcoholic beverages, cigarettes, and so on.

Today, VAT represents around 19.92 percent of total state revenue, compared to 9.77 percent from income tax and 6.83 percent from corporate tax.[xiii] VAT has been reformed several times over the years, most recently in 2017, with a rate increase of 1 percent. VAT is now imposed at 19 percent, with a 7 percent rate for health services, hotels, and catering services, and a 12 percent rate payable for services from independent professions (such as lawyers and doctors), electricity, and oil production. However, no published data exists on the exact revenue generated by each tax rate.

The VAT burden usually falls on the consumer, since the tax is placed on a product whenever value is added at each stage of the supply chain, from production to the point of sale. In addition, VAT rates do not take individuals' income levels into account, thus impacting their purchasing power and even access to basic needs.

One tax burden analysis has shown that consumption duties and VAT reduce the market income of the lowest third in Tunisia by an average of 15.17 percent.[xiv] However, these results are not only restricted to low-income groups. Considering the nature of the tax, where it increases as a percentage of total expenditure of disposable income, it represents the same burden on high-income groups.

Even though the VAT and consumption duties burden is the same for all income groups, its impact is felt differently from one group to another. Poor households tend to be net consumers with little, if any, savings. Thus, an increase in VAT will negatively impact their purchasing pattern, and thus their consumption too. On the other hand, better-off households tend to be net savers, so an increase in VAT will result a change to saving patterns, while keeping their consumption constant. Considering the huge impact of taxes on individuals and the private sector, and especially in relation to last year's public protests against the Finance Law and the deterioration of living standards, it is now crucial for Tunisia to review some of its tax rates and policies, in order to promote economic growth, and reduce both poverty and inequalities.

Recommendations

Under the scope of the Finance Law of 2019, policy-makers should:

- *Review the applicable income tax rates and brackets*

The inflation rate under which the applicable rates were designed has increased by 1.4 percent over the past year, which has impacted the purchasing power and living standards of individuals dramatically. One study has shown that these rates burden lower-income groups to an even greater extent.[xv] To solve this, tax brackets should be reviewed, either through further dividing the income bracket into multiple income brackets, thus achieving have a more progressive income tax, or through further exemptions of lower-income groups from paying.

This provision will reinforce the purchasing power of individuals, and also result in greater economic activity through increased consumption.

- *Opt for a Progressive Corporate Tax*

The Finance Law of 2018 established a tax rate that takes companies' revenue levels into consideration. This provision falls under the scope of promoting and enhancing the growth of small and medium enterprises (SMEs).

Noting that more than two-thirds of the private sector is composed of SMEs, with differing revenues, this rate should be made more inclusive for other SMEs, independent from the sector of activity, in order to allow them more funds to invest and enter new markets, thus enhancing economic growth.

- *Review VAT*

Although VAT represents an important source of income for the state budget, there is no doubt that it also represents a burden on consumers.

Due to the lack of data on the amount generated from each taxable service and good, it is not possible to target a specific tax rate. However, when reviewing VAT, deputies are encouraged to request the amounts generated from each rate, and their evolution over recent years. This type of information is crucial for deciding which services and goods should be taxed less (or more), while bearing in mind the possible impact of these rates on poorer households.

Reducing VAT rates or exempting certain goods and services will certainly impact the state budget, causing a loss in state revenues. Nonetheless, reinforcing efforts to date, and increasing the means to tackle tax evasion and fraud, estimated at around 40 percent,[xvi] is one part of the solution.

Oumaima Jegham

Notes

[i] Report on the Finance Bill of 2018, p. 21 <http://www.finances.gov.tn/index.php?option=com_jdownloads&Itemid=722&view=finish&cid=1287&catid=10&lang=ar-AA> (accessed December 6, 2018).

[ii] Unemployment figures from the Institut National de la Statistique (INS) <http://www.ins.nat.tn/fr/themes/emploi#1908> (accessed December 6, 2018).

[iii] Budget deficit figures from the Ministry of Finance <http://www.finances.gov.tn/index.php?option=com_content&view=article&id=73&Itemid=447&lang=ar-AA> (accessed December 6, 2018).

[iv] "Synthèse des Résultats des Finances Publiques (Budget de l'Etat)," Ministry of Finance <http://finances.gov.tn/index.php?option=com_content&view=article&id=134&Itemid=304&lang=fr> (accessed November 14, 2018).

[v] "Tunisie: Rapport de suivi de la situation économique," World Bank, 2018 <https://www.banquemondiale.org/fr/country/tunisia/publication/economic-outlook-april-2018> (accessed November 14, 2018).

[vi] "Rapport de l'observatoire social Tunisien," Forum Tunisien des droits economiques et sociaux, March 2018, p. 9 <https://ftdes.net/rapports/fr.mars2018.pdf> (accessed December 6, 2018).

[vii] "Tunisia's Constitution of 2014," Constituteproject.org, July 27, 2018 <https://www.constituteproject.org/constitution/Tunisia_2014.pdf> (accessed November 14, 2018).

[viii] Table 1 (1986-1989): Finance Law 1986, Article 8 <http://www.legislation.tn/sites/default/files/journal-officiel/1985/1985A/Ja09185.pdf> (accessed December 6, 2018). Table 2 (1989-2016): Habib Ayadi, "Droit fiscal," (Tunis: CERP, 1989). Table 3: Finance Law 2017, Article 14.

[ix] Nizar Jouini et al., "Fiscal Policy, Income Redistribution and Poverty Reduction: Evidence from Tunisia", CEQ Institute, Working Paper No. 38, January 2017, p. 4.

[x] These results were obtained through comparing the Gini index before and after the application of income tax, as well as adding simulated benefits from social programs.

[xi] Amine Bouzaïene, "Equité fiscale et système d'imposition en Tunisie", Observatoire Tunisien de l'économie, Briefing Paper No. 4, November 22, 2017 <http://www.economie-tunisie.org/sites/default/files/20171010-bp-equitefiscale-ab-fr.pdf> (accessed November 14, 2018). The 35 percent rate was changed by Article 1 of Law No. 80 of 2006 on reducing tax and tax burdens on

companies. Law in Arabic, p. 4 <http://www.legislation.tn/sites/default/files/journal-officiel/2006/2006A/Ja1012006.pdf> (accessed December 7, 2018).

[xii] The original post in Arabic from Al Bawsala <https://www.facebook.com/AlBawsala/photos/a.458257467540418/1782701991762619/?type=3&theater> (accessed December 7, 2018). The data was taken from the Finance Bill of 2018: <http://www.finances.gov.tn/index.php?option=com_jdownloads&Itemid=722&view=finish&cid=1287&catid=10&lang=ar-AA> (accessed December 7, 2018).

[xiii] This is our own calculation based on the numbers presented in the Finance Bill: <http://www.finances.gov.tn/index.php?option=com_jdownloads&Itemid=722&view=finish&cid=1287&catid=10&lang=ar-AA> (accessed December 7, 2018).

[xiv] Jouini et. al.

[xv] Ibid.

[xvi] Ibid.